# Public Service Commission of the District of Columbia

717 14TH STREET, N.W.
WASHINGTON, D.C. 20005
(202) 626-5100

IN REPLY REFER TO:

June 13, 1997

The Honorable John D. Dingell, Ranking Member
Commerce Committee Democratic Office
564 Ford House Office Building
U. S. House of Representatives
Washington, D.C. 20515

Re: Proposed Electricity Industry Legislation

Dear Congressman Dingell:

Enclosed is the District of Columbia Public Service Commission's ("Commission") response to your letter and questionnaire of April 10, 1997. The case load at the Commission is extremely heavy, so please accept our apology for failing to respond by the date you requested. In your letter, you indicated that Congress is considering whether to enact legislation concerning the electricity industry. The information forwarded to you has been compiled and reviewed by the Commission's technical and legal staff and has been developed to provide you with as much information as possible for each question set forth. If you or your staff require further information regarding a specific question or concept, please do not hesitate to contact Norman Reiser, our Director of Office of Technical Advisory Services at (202) 626-5136.

Sincerely,

Marlene L. Johnson, Esq.
Chairperson

## QUESTIONS FROM THE U.S. HOUSE OF REPRESENTATIVES COMMITTEE ON COMMERCE EXAMINING WHETHER CONGRESS SHOULD ENACT LEGISLATION CONCERNING THE ELECTRICITY INDUSTRY

**1. Has your Commission or State legislature considered or adopted retail competition? If retail competition is occurring at this point, what effect has it had on consumer prices?**

Yes; however, retail competition has not yet been implemented in the District of Columbia. The District of Columbia Public Service Commission ("DCPSC") has initiated a proceeding (Formal Case No. 945, entitled "The Investigation Into Electric Services, Market Competition and Regulatory Policies") to consider, among other issues, retail competition and the restructuring of the electric industry. Commission action will depend upon the findings of this proceeding, which is expected to conclude in late 1997. Our local legislature has not considered or adopted retail competition.

**2. Has your State asked Congress to enact legislation mandating retail competition? Has it sought Congressional action to enable or assist it in adopting retail competition? Has it requested or recommended any type of Congressional action?**

No to all parts of the question.

**3. Does your Commission currently have sufficient authority to resolve stranded cost issues in the event Congress enacts legislation providing for retail competition by a date certain? If not, what timing and other problems might ensue? What could Congress do to address any such problems?**

Yes. This Commission generally has the authority to resolve stranded cost issues.

**4. Are there any other areas in which your State currently does not have the necessary authority to address issues arising from federal legislation mandating competition, or repeal of the Public Utility Holding Company Act of 1935 (PUHCA) or the Public Utility Regulatory Policies Act of 1978?**

No. Currently, the DCPSC has the necessary authority to resolve general issues which we would expect to arise from federal legislation mandating competition. However, without a specific proposal in front of us, we are unable to determine if requirements might be mandated for which we do not have enabling authority.

**5. Would any constitutional issues be raised by federal legislation:**

**a. mandating that states choose between adopting retail competition by a date certain and having a federal agency preemptively impose retail competition?**

The Fifth Amendment "takings clause" may arise if Congress, when promulgating federal legislation, does not provide for appropriate compensation. The takings clause may be invoked if, for example, an existing utility company is forced to share property such as transmission poles, lines, etc., with a competitor or forfeit vital market shares.

**b. requiring states to conduct a proceeding on retail competition, reserving to the states discretion not to adopt retail competition if they determine doing so would not be in its consumers' best interests?**

We do not believe any constitutional issues would be raised.

**6. From a practical standpoint, what problems would arise if Congress adopted legislation mandating retail competition which did not grandfather prior state action?**

Several practical problems would arise if Congress adopts legislation mandating retail competition which does not grandfather prior State action. First, several States are in varying stages of developing and/or implementing retail competition. In some instances, this includes pilot projects designed to determine the potential impacts of retail competition. Congressional mandates may be inconsistent with time-lines for such State programs, resulting in the abrupt curtailment of existing pilots and other programs already in progress. This could hurt States with well thought-out plans to phase in retail competition. Moreover, potentially valuable information for both shareholders and ratepayers might be lost if these pilot programs are stopped short of their completion.

Second, if Congress adopts legislation mandating retail competition which does not grandfather prior State action, the Congress would create another class of stranded costs. These would be the costs associated with State and company initiatives to phase-in retail competition, including pilot projects, already in progress. The monies expended on such phase-in efforts and pilot projects would simply be wasted. Electric companies, however, would likely pursue collection of such expenditures as stranded costs.

Third, if Congress adopts legislation mandating retail competition which does not grandfather prior State action, existing State requirements related to safety, reliability and just and reasonable rates may be in jeopardy. Many of these requirements were implemented to protect the health and safety of the public and the economic viability of certain ratepayer classes. For example, decisions related to reserve margins are necessary to maintain reliable service in the event of unscheduled production outages and/or extreme weather conditions. Without these margins, electricity services may not be available to certain classes of ratepayers in extreme circumstances or they may not be available at affordable rates.

**7. In hearings before the Energy and Power Subcommittee during the last Congress, some witnesses took the position that Congressional legislation mandating retail competition is necessary to protect the interest of small business and residential consumers. This was based on the assertion that large industrial customers are able to negotiate lower rates with state utility commissions, and that the incidence of such rate reductions is on the increase.**

**a. Are you aware of any study or analysis relevant to your State that supports this conclusion?**

No. The District of Columbia does not have any large industrial customers. However, similar concerns exist in the District of Columbia between large government and/or commercial customers, and small business and residential customers. For example, the General Services Administration, the Washington Metropolitan Area Transit Authority, a collection of large office and/or apartment buildings, and a large universities or hospitals located in our city may be better able to negotiate lower rates. This issue of enhanced negotiating power by large users is one being considered by the DCPSC in the Formal Case referenced in our answer to Question 1 above.

**b. Please provide any information you can on the historical relationship between residential and industrial rates, the extent to which one customer class has subsidized another, and whether or not this trend has altered in recent years.**

As indicated in the response to 7 a (above), the District of Columbia does not have any industrial customers. However, as also indicated above, such concerns do exist between (a) large government and/or commercial customers, and (b) small business and residential customers. Historically, the only rate classes that have been the direct beneficiaries of subsidization in the District of Columbia have been the municipal street lighting and traffic signaling services. These rates have trended downward since 1994. These trends are illustrated in the table presented in response to Question 8, below.

**8. Although electricity rates vary widely within the U.S., they have fallen recently in some parts of the country. Please provide any information you can about rate trends in your State, and how they affect various customer classes.**

Historically, District of Columbia ratepayers have enjoyed rates slightly below or close to the national average. However, and as noted in our answer to Question 7 (b) above, the only customers who have experienced actual rate declines are in the street light and traffic signal classes. Please see the table below for average electricity rates and their historical trends for each customer class for the years 1990 through 1996, expressed in cents/KWH.

District of Columbia
Average Cost of Electricity Per KWH

| | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 |
|---|---|---|---|---|---|---|---|
| Residential | 6.18 | 6.69 | 6.70 | 7.31 | 7.58 | 7.75 | 7.86 |
| Residential All-Electric | 5.74 | 6.12 | 6.20 | 6.66 | 6.94 | 7.11 | 7.38 |
| Residential Time Metered | 7.68 | 8.19 | 8.54 | 9.08 | 9.33 | 9.52 | 9.67 |
| Residential Time Metered Experimental | 8.06 | 8.15 | 8.29 | 8.33 | 9.68 | 9.28 | 9.42 |
| General Service | 7.20 | 7.57 | 7.84 | 8.20 | 8.63 | 8.68 | 8.97 |
| Time Metered General Service | 5.61 | 5.90 | 6.18 | 6.43 | 6.77 | 6.75 | 6.99 |
| Temporary | 9.99 | 10.23 | 10.84 | 11.42 | 12.10 | 11.98 | 12.43 |
| Street Light | 3.08 | 3.14 | 3.16 | 3.36 | 3.53 | 3.08 | 2.91 |
| Traffic Signal | 3.43 | 3.45 | 3.49 | 3.69 | 3.87 | 3.34 | 3.10 |
| Rapid Transit | 6.05 | 6.41 | 6.69 | 6.92 | 7.29 | 7.28 | 7.46 |
| Telecommunications Network | - | - | - | - | - | - | 9.94 |

9. **Some proponents of retail competition hold the view that all electricity resources should be sold at a market price and that state authority to regulate retail rates should be eliminated. How would such a policy affect shareholders and ratepayers? What mechanisms could states or Congress employ to manage these issues? In a restructured electric industry, who should receive the benefits of these low-cost resources — utility ratepayers, utility shareholders or the highest bidder?**

There will be many groups of winners and losers among both ratepayers and shareholders if electricity resources are sold at a market price and State authority to regulate retail rates is eliminated. Winners and losers would be determined by such variables as ability to pay, the level of market clearing prices and the cost structures of respective utility companies.

First, there could be a possible effect on ratepayers from a relatively high market clearing price, absent State regulation. These high prices could result from the market power of a supplier or group of suppliers. Ratepayers less able to afford the higher prices would be forced out of the purchasing market. This expected burden would be heaviest on small businesses and residential ratepayers, the customer classes generally least able to afford higher prices. An important part of a State authority to regulate rates includes maintaining rates designed to approximate universal service at reasonable prices to all consumers.

Second, there could be a possible effect on shareholders from a relatively high market clearing price, absent State regulation. Shareholder wealth depends upon the revenue and net income of the investor owned utility (IOU). In turn, the revenue and net income of the IOU depends, in part, on the level of electricity sales. If the high prices are associated with a high level of sales, the revenue and net income of the IOU will increase, resulting in increased shareholder wealth. Alternatively, shareholder wealth might decrease if consumers respond to high prices by significantly reducing purchases of electricity.

Third, there could be a possible effect on ratepayers from a relatively low market clearing price, absent State regulation. In that case, all rate payers will be better able to afford electricity and demand could increase. This has the potential to result in the excessive usage of electricity, which relies upon scarce resources at the generation level.

Fourth, and finally, there could be a possible effect on shareholders from a relatively low market clearing price, absent State regulation. Again, the shareholder wealth depends upon the revenue and net income of the IOU. However, the price may not adequately cover the capacity and energy costs of all electricity generators. The IOUs with low cost generation facilities may be expected to operate profitably. However, those with high cost generating facilities are most likely to incur negative income, resulting in greater loss of shareholder wealth.

The appropriate mechanisms necessary to manage the restructuring issues are already being designed and/or implemented by the States as they proceed toward restructuring.. Several States have pilot programs in progress to gain more information regarding the effects of restructuring on various classes of customers and the shareholders of the IOU's. Other States have pilot programs under consideration. Still other States are setting exact time-tables for complete restructuring. We believe that State Commissions have the greater expertise at balancing the interests of both shareholders and ratepayers in their particular States. We also believe that the most constructive approach that Congress can take is to proceed cautiously until more information is gained from the various experiments and pilot programs being undertaken at the State level. One approach would be to establish a Congressional Task Force to monitor the progress and report back to Congress in a stated period of months, and base any further legislative initiatives on the solid information available from the activities now in progress at the State level, including the California PUC decision on May 7, 1997 to suspend the transition process and go directly to retail competition on January 1, 1998.

In a restructured electric industry there is no guarantee of an abundance of low cost resources. We believe that most proposals for the full recovery of stranded costs will inflate market prices for several years into the future. This will result in continued high prices for ratepayers. Moreover, some States already have IOU's with a low cost generating mix, while other States do not. To the extent that low cost resources are determined to exist, there should be an equitable sharing of benefits between all stake holders. Public interest concerns require that no one bidder or group of bidders be able to command market power sufficient to deny an equitable delivery of services at reasonable rates to all classes or groups of ratepayers. We believe that State Commissions are the best vehicles for providing a level playing field during the transition to a restructured electric industry. Moreover, State Commissions are the appropriate vehicle for maintaining a level playing field when the restructuring process is completed.

**10. Of those States which have adopted retail competition, how many have addressed the issue of "reciprocity", (that is, whether or not the state can bar sellers located in States which have not adopted retail competition from access to its retail markets)? Whose interests does a reciprocity requirement affect? Is a reciprocity requirement the only way to protect those interests, or are there alternatives? Would such a requirement raise constitutional issues?**

The reciprocity issue has been addressed by all States which have adopted retail competition. The reciprocity issue is of particular importance to States which currently have available a 'low-cost' generation-mix from their respective monopoly suppliers of electricity. When demand from other jurisdictions goes up, it has the potential to increase the market sales price of all electricity. The jurisdictions whose rates currently reflect this availability of a low cost generation mix will be the losers. In particular, some District of Columbia ratepayers have the potential to be negatively impacted by retail competition. Large customers from neighboring jurisdictions could use the advantage of reciprocity to exercise their market power to command low cost resources now available for District customers. In particular, small businesses and residential customers may not have the market power to compete for the low-cost power they now purchase.

We do not believe that a Congressionally-mandated reciprocity requirement would raise any constitutional issues.

**11. If Congress were to require "unbundling" of local distribution company services as part of a retail competition mandate, what practical problems might this present to state regulators?**

Several practical problems associated with the mandatory unbundling of a local distribution company services might occur. Among these practical problems are, first, that it is not always possible to clearly distinguish between the joint and common costs of particular utility services. Detailed cost analysis would have to be performed to arrive at appropriate allocation methodologies. Second, any necessary cost allocations must be revenue-neutral between classes of ratepayers. However, customers may change their level of usage in response to price changes. It is not possible

to predict precisely such behavior. For this reason, a certain amount of judgement is exercised in allocating customer costs. Third, unbundling should occur for only those services for which it is cost-effective for a third party to supply. For example, it may not be cost-effective to replace metering equipment; in such an instance, metering should not be unbundled. Fourth, necessary accounting safeguards must be in place to guard against cross-subsidization, or the supporting of unregulated functions by regulated revenues. Finally, the unbundling process could become very complex if it is necessary to design rates for each unbundled service. It may be necessary to establish unique rate setting procedures for individual service items. Each service item may require its own cost-allocation methodology and study.

**12. Does your Commission face particular problems in connection with public power or federal power in a increasingly competitive electricity market?**

No. The District of Columbia does not have a public power or federal power presence.

**13. How would federal legislation mandating competition by a near term date certain affect funding needs for your Commission? If additional funding were needed, would it be available, and what problems might arise if it were not?**

Federal legislation mandating competition by a near term date certain would have a significant and deleterious impact upon the funding needs of the DCPSC. By statute, the funding for the DCPSC is derived from assessments against the revenues of our existing monopoly. Thus, regulatory and/or monitoring activities involving new competitive market entrants cannot be conducted with these funds. Our local legislature would need to enact enabling funding and/or assessment procedures to require new competitors to make proportionate contributions to our operating budget. The time necessary for such action by our legislature may not be consistent with a "near term date certain".

Without local legislative action to assess new entrants, additional funding would not be available for the DCPSC. No money can be expected from District of Columbia General Revenue Funds. Absent such funding, the DCPSC would be unable to take any implementation measures associated with new competitors.

**14. Has your Commission considered or adopted securitization plans as a means of providing for recovery of utility stranded assets? What risks are inherent in this approach, and who bears them?**

The general issue of stranded costs is being considered by the DCPSC in the Formal Case referred to in answer to Question 1. No participants in that Formal Case have offered a securitization plan as a means of providing for the recovery of utility stranded assets. However, the record in the case is still open, and Commission action will depend upon the findings of this proceeding.

A stranded asset securitization program may contain risk for both the shareholders and ratepayers, as well as both the existing and the securitized bondholders. Under stranded asset securitization

programs, stranded assets are sold to a financing subsidiary and ultimately to a trust that issues bonds in the amount of the stranded asset or some fraction of the amount of the stranded assets. The proceeds from the sale of the bonds are immediately available to the utility company as compensation for the stranded assets. The revenue or cash flow necessary to support the interest and debt repayment on the bonds is derived from a Commission-imposed charge on utility customers, such as California's "competitive transition charge" ("CTC"). Credit-worthiness of the bonds depends upon the degree to which the CTC is irrevocable. If the CTC cannot be revoked, it is reasonable to expect the bonds to have favorable carrying charges, and vice versa.

What is sometimes claimed to be a benefit for ratepayers could be a disguised burden to the extent that all of the risk of stranded asset recovery is placed on the ratepayers. The purported benefit to the ratepayers is the potential for debt carrying charges to be lower than the company's cost of capital for the stranded assets that have been securitized. It may be erroneous, however, to classify this as a benefit. Lower debt carrying charges merely represent the degree to which ratepayers are irrevocably committed to paying the full bill for the stranded assets and the carrying charges of the respective debt. In exchange for receiving a benefit, ratepayers are, in actuality, bearing the full risk of stranded cost recovery.

The relative wealth of the shareholder may be also at risk, depending upon how the utility manages the cash proceeds from the bond securitization. The wealth or value of a company to its shareholders depends on the income generated by the company. When the utility company receives the proceeds from a bond sale, it can reduce outstanding debt and repurchase outstanding shares of stock to achieve a shrinking of the company reflecting the size of the transferred assets, or it must find a reinvestment opportunity commensurate with the revenue stream previously associated with the stranded assets. Otherwise, the wealth of the shareholders will be decreased.

Existing bondholders may also be at risk, depending upon how the IOU manages the proceeds from the sale of the securitized bonds. If the IOU does not retire outstanding debt proportionate to the value of the stranded assets, the interest coverage ratios of the IOU will decline. This will drive down the market value of the bonds outstanding.

Finally, securitized bondholders may ultimately be at risk if future Commissions or legislatures overturn the CTC under which the bond repayment and carrying charges are being covered. They would thus lose their investment in the bonds which were securitized by the charge to electric customers. However, in the instances where securitization have occurred, the CTCs have been considered irrevocable.

**15. There is a wide divergence of opinion as to whether or not PUHCA should be modified or repealed. Given the record level of merger activity, this question may become significant for all state regulators, whether or not they currently have regulatory responsibilities relating to registered holding company activities.**

**a. Do you believe PUHCA impedes competition, at the wholesale or retail level? Can "effective competition" be achieved regardless of whether Congress enacts changes to PUHCA?**

We believe PUCHA does impede competition at the retail level because it has discouraged electricity companies from crossing State lines to compete. Nonetheless, savvy companies have found ways to remain exempt from PUHCA requirements altogether. On the wholesale level, PUCHA does not impede competition because the Energy Policy Act of 1992 permits ownership of foreign utility companies by registered holding companies. It appears that effective competition can be achieved regardless of whether Congress enacts changes to PUHCA. This is premised upon the large number of firms that appear ready to enter the market with PUHCA still in place and current State action to open markets to competition in Massachusetts, New Hampshire, and California..

**b. Do you believe Congress should modify or repeal PUHCA? If so, why, and under what if any conditions?**

Since the District of Columbia does not have any utilities that operate under PUHCA, we do not have first hand knowledge of problems unique to PUHCA. However, if PUHCA is modified or repealed, it is imperative that State Commissions be granted access to the books and records of all subsidiaries that have transactions with regulated utilities in order to determine if inter-company pricing is in compliance with State Commission standards.

**c. Should Congress enact legislation to modify the holding in Ohio Power Co. V. FERC, 954 F.2d 779 (D.C.Cir. 1992)?**

Yes. The SEC is not the appropriate agency to review transactions between regulated and non-regulated subsidiaries. Companies that are subject to PUHCA also should be subject to the jurisdiction of the Federal Energy Regulatory Commission ("FERC") and the States as far as transactions between regulated utility subsidiaries and non-regulated subsidiaries to determine if inter-company pricing is in compliance with State Commission standards. We believe that State Commissions and FERC have the greatest expertise in reviewing such transactions.